
UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE NINTH CIRCUIT.

Nos. 11488-11489.

CALIFORNIA AND HAWAIIAN SUGAR REFINING CORPORATION,
LTD., a corporation, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

SUPPLEMENTAL BRIEF FOR PETITIONER.

FILED

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PAUL P. O'BRIEN,

HENRY J. RICHARDSON,
Transportation Building,
Washington 6, D. C.

WALTER C. FOX, JR.,
111 Sutter Street,
San Francisco 4, California,
Attorneys for Petitioner.

INDEX.

	Page
QUESTION 1: As to required disallowance based on insufficiency of claims	1
ANSWER: No. See Stipulation	1
STIPULATION OF COUNSEL FOR THE PARTIES	1
DISCUSSION OF BOGARDUS CASE	2-10
QUESTION 2: As to Agency	10
ANSWER: No. The necessary elements of agency are not present	10
QUESTION 3: As to a Trust	15
ANSWER: Yes. All the necessary elements of a trust are present	15
QUESTION 4: As to shifting the tax by a trust.....	18
ANSWER: No. This is the only method of bearing the tax—not shifting it	18
QUESTION 5: As to where a net loss would fall.....	22
ANSWER: On the capital of the cooperative trustee with definition of the term “net loss”.....	22

LIST OF AUTHORITIES CITED.

CASES:

Anniston Manufacturing Company v. Davis, 301 U. S. 337, 57 S. Ct. 860	20
Ansley Realty Co. v. Pope, 105 Texas 440, 151 S. W. 525	12
Bogardus v. Santa Ana Walnut Growers Assoc., 41 C. A. (2d) 939	2, 4, 5, 6, 8
California Canning Peach Growers v. Downey, 76 Cal. App. 1, 243, P. 679	3
Cheek, et al. v. U. S., 40-2 U. S. T. C. par. 9687, affirmed C. C. A. 6, 126 F. (2d) 1	14
Mountain View Walnut Growers Ass'n. v. Calif. Walnut Growers Ass'n., 19 Cal. App. 2d 227, 65 P. 2d 80	5
Reinert v. California Almond Growers Exchange, 9 Cal. 2d 181, 70 P. 2d 190	5
Rhodes v. Little Falls Dairy Company, Inc., 230 App. Div. 571, 245, N. Y. S. 432, 434, 435.....	3, 5

River Orchard Company v. Stone, 97 Oreg. 158, 191 Pac. 662	6
San Joaquin Valley Poultry Assoc. v. Commissioner, 136 F. (2d) 382 (C. C. A. 9)	5
Schuster v. Ohio Farmers' Cooperative Milk Assoc., 61 F. (2d) 337 (C. C. A. 6)	9
Taylor v. Davis, 4 S. Ct. 147, 150, 110 U. S. 330....	13, 19
Texas Certified Cottonseed Planters Associations v. Aldridge, 122 Texas 464, 61 S. W. 2d 79	5

STATUTES:

California Agricultural Code, Sec. 1192.....	9
Sec. 1208.....	10
Sec. 1210.....	12
Sec. 1206.....	12, 22

MISCELLANEOUS:

2 C. J. S. 1035, Note 33 and 34	13
Hulbert, L. S., Legal Phases of Cooperative Associations, Bulletin 50 May 1942, Farm Credit Administration, Dept. of Agriculture....	3, 6, 7, 8, 9, 16, 23
Nourse, "The Legal Status of Agriculture Cooperation", Macmillan 1928.....	9
Restatement of the Law of Agency, Sec. 1, Sec. 14 and Comment c	12, 14
Sec. 18 and 19	13
Sec. 118-121	14
Restatement of the Law of Trusts, Sec. 8.....	13
Sec. 2 and comment h	15
Sec. 3	17
Sec. 128, 275	19
Sec. 261-263	19
Sec. 274	22
Scott on Trusts	15, 16, 17

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SUPPLEMENTAL BRIEF FOR PETITIONER.

Pursuant to Order of the Court herein filed with the Clerk on July 21, 1947, petitioner respectfully submits as its brief on the questions therein stated, the following:

After observing that "Nowhere in the petitions is it alleged that the evidence supplied the Commissioner is under oath. The copies of the claims attached to the petitions show they were not verified," the Court asks:

Question 1. *Does the record in this respect require us to hold that the Commissioner's disallowance of the claims must be upheld?*

Answer: No. Please see stipulation of counsel for the parties signed on July 23, 1947 and mailed to the Clerk on July 24, 1947 for filing, as follows:

"It is hereby stipulated by and between counsel for the respective parties in the above entitled cases that

the original claims filed on the prescribed forms, unsigned copies of which appear in the Record in No. 11488 at pages 17 to 98, inclusive, and in the Record in No. 11489 at pages 13 to 26, inclusive, were subscribed and sworn to by C. E. Schink, Treasurer under the name of California and Hawaiian Sugar Refining Corporation, Ltd., in accordance with regulations prescribed by the Commissioner with the approval of the Secretary."

By way of apology and explanation counsel for petitioner states that the photostatic copies of the claims for refund attached to the petitions in the Tax Court were made from retained carbon copies of the claims as prepared for filing which through oversight were not conformed with the original of the claims after being signed and sworn to.

It is believed that proof of such filing under oath in the form of the claims for refund that were filed, and which are in the Commissioner's possession, would be admissible under the allegations of the petitions at Par. V (4) of the petition in No. 11488 (R. 7) and in Par. V (6) of the petition in No. 11489 (R. 7) if answers had been filed by the respondents denying such allegations.

The allegations are that "Petitioner complied with the provisions of Title VII and timely filed its claim for refund of the tax paid by it as aforesaid" etc. and, of course, said allegations must be considered as admitted for purposes of the motions to dismiss the petitions herein.

With respect to the remaining questions which are prefaced by the Court's reference to the duty of counsel and their failure to cite or consider the case of *Bogardus v. Santa Ana Walnut Growers Association*, 41 C. A. (2d) 939, counsel for petitioner is very happy for this opportunity to give his views. By way of explanation it is stated that counsel for the petitioner was familiar with the decision in the *Bogardus* case but it was not then recognized that the holding thereof was responsive to or depositive of any ground mentioned by the Tax Court in support of its deci-

sion, nor to the grounds relied on in the brief for the respondent in this Court. In another connection, namely that dealing with the pattern of the margin computations prescribed in Sec. 907 petitioner's brief before the Tax Court contains the following with reference to the relationship between a cooperative and its members.

“With respect to the relationship between a cooperative and its members one writer (L. S. Hulbert, *Legal Phases of Cooperative Associations*, published as Bulletin 50—May 1942, Farm Credit Administration, U. S. Department of Agriculture) has this to say:

‘It is apparent that the relationship between the members and the association is much more intimate and personal than that between an ordinary corporation and its stockholders. The courts have recognized that this is true. (citing *California Canning Peach Growers v. Downey*, 76 Cal. App. 1, 243, p. 679.) It has been said (citing *Rhodes v. Little Falls Dairy Company, Inc.*, 230 App. Div. 571, 245 N. Y. S. 432, 434, 435, affirmed in 256 N. Y. 559, 177 N. E. 140):

“Even though title may have passed, still the arrangement is for cooperative marketing. The status of the parties partakes of a trust or fiduciary character, and is not the simple relation of vendor and vendee; the fund derived from the marketing of the product being subject to distribution among the various producers, sales of whose product had gone to make it up.

* * * * *

“There was a fiduciary relationship here; defendant was dealing with plaintiff's property. It was its duty to get the best price possible for it, to make such deduction from the proceeds for expenses and other items mentioned in the contract as were required in necessity and reason, and to return to plaintiff his share of the profits remaining, if such there were, based upon the milk that he furnished. * * *

'In a nonlegal sense a cooperative partakes of the nature of a joint enterprise or partnership. Membership in a capital-stock cooperative association is had through the purchase of a share or shares of its stock and the meeting by the purchaser of any other authorized requirements of the association; membership in a nonstock cooperative association is had through application for membership and acceptance by the association and the meeting of any other authorized requirements. A common requirement for both stock and nonstock associations is the signing of a marketing contract.

'It should not be assumed that the members or stockholders of a cooperative association, except in a technical legal sense, are separate and apart from the association. * * * ,'

While the question now posed by this Court as to the definitive legal category of the relationship is not disposed of in the foregoing description, the fiduciary character of the relationship was at least there pointed out. In the Tax Court's opinion no mention of this relationship is made in any connection.

Some analysis of the *Bogardus* case and the cases cited therein as a preface to their application in answer to the questions propounded by this Court seems appropriate.

In the *Bogardus* case the action was for an injunction and declaratory judgment by some of the members of the cooperative association which was about to pay shares of a revolving fund derived from the sale of products, to persons who were no longer members but who had supplied products while they were members, out of which the revolving fund was created. The decision is based upon an interpretation of the by-laws of the cooperative association. In arriving at the decision the Court there stated that the relationship between the member and the association "was that of principal and agent, or beneficiary and trustee; that a fiduciary relationship existed which required at all times that these associations account to the grower member for all proceeds received from the sale of walnuts * * * ,'

It will be noted that the terms "principal and agent, or beneficiary and trustee" are used interchangeably or without distinction as constituting a "fiduciary relationship." It will be seen from the citations *infra* that both an agent and a trustee are fiduciaries in their respective capacities.

In the cited case of *Texas Certified Cottonseed Planters Association v. Aldridge* (122 Texas 464 61 SW 2d 79) the court specifically held that the marketing contract was a contract of purchase and sale and not of agency.

In the cited case of *Rhodes v. Little Falls Dairy Company, Inc.* (230 App. Div. 571) the action was one in equity for an accounting under a purchase and sale contract by which the producer was to receive a share of the profits from the distribution of his product. Little Falls Dairy Company, Inc. does not appear to have been a cooperative association but Rhodes' contract with it created a fiduciary relation between them calling for an accounting in equity.

In *San Joaquin Valley Poultry Association v. Commissioner*, 136 F. (2d) 382 (C. C. A. 9) this court cited the *Bogardus* case for the following statement (L. C. 385):

"The sums so placed in these reserves—the \$1,683.56, the \$2,215.29, the \$5,722.72, the \$2,601.90 and the \$5,358.46—never became the property of petitioner, but were and are the property of the members. *Bogardus v. Santa Ana Walnut Growers Ass'n*, 41 Cal. App. 2d 939, 946-949, 108 P. 2d 52, 56-58. See, also, *Mountain View Walnut Growers Ass'n v. California Walnut Growers Ass'n*, 19 Cal. App. 2d 227, 65 P. 2d 80; *Reinert v. California Almond Growers Exchange*, 9 Cal. 2d 181, 70 P. 2d 190. To hold otherwise would be to hold that petitioner could and did 'make a profit for itself, as such,' in contravention of its by-laws, its articles of incorporation and the statute to which it owes its existence. *Bogardus v. Santa Anna Walnut Grower Ass'n*, *supra*.

"Petitioner never pretended to be the owner of these sums, but, as required by its by-laws, 'prorated' and credited them to its members. The fact that the sums were not payable to the members on demand, or at any fixed time, does not alter the fact that they were

their property and not petitioner's. Petitioner held them, not as owner, but *as agent or trustee* for the members. *Bogardus v. Santa Ana Walnut Growers Ass'n*, supra. Since none of the sums ever belonged to petitioner, they could not be, and were not, income of petitioner." (Emphasis supplied)

Here again the words "agent" or "trustee" appear to be used interchangeably. With deference to this Court it may well be doubted whether the word "agent" is equally applicable with the word "trustee" to describe the capacity of the cooperative in that case. Bearing in mind that the matter dealt with in that case was money or property held in reserves which had been taken out of the proceeds of the cooperative operation which had become profits and which were, under California law, the profits of the members, and that undoubtedly legal title to, and administrative control over, the property constituting the reserves was in the cooperative association, it would seem that the proper description of the capacity of the cooperative association was that of "trustee" rather than that of "agent." Reference in this case to the reserves as being "property of the members" might also be appropriately qualified as property belonging beneficially to them since legal title thereto and control over said property was definitely in the cooperative association.

In the book "Legal Phases of Cooperative Associations" by L. S. Hulbert, published by the Farm Credit Association, U. S. Department of Agriculture, as Bulletin 50, May 1942, which is referred to and quoted from in the above excerpt from petitioner's brief before the Tax Court, the *Bogardus* case is cited in connection with five different statements. At page 5 it is cited in support of the above quoted statement from brief before the Tax Court. At page 74 it is cited in connection with the following statement and quotation from an Oregon case, *River Orchard Company v. Stone*, 97 Oreg. 158, 191 Pac. 662. The facts of that case are almost exactly on all fours with those in the *Bogardus* case.

“A clear distinction should be drawn between amounts claimed by a member under his contract with an association and amounts claimed by him by reason of his membership therein. In an Oregon case, an association that was engaged in growing apples was a member of a marketing association. The former association canceled its membership in the latter and later brought suit against this association on its contract. The court said that:

‘Under the terms and conditions of the contract, standing alone and complete within itself, the grower is entitled to receive each year the balance of any net proceeds from an annual pool, within 30 days after the receipt of the money by the association, and it is the duty of the association to render an annual statement of the receipts and disbursements of each pool. The record is conclusive that such statement was never made and such accounting was never rendered to the plaintiff; that, after paying the expenses of the association named in the contract, there is a surplus estimated to be about \$ 80,000.’

“The marketing association claimed that, by reason of a bylaw which provided that the cancellation of the standard contract shall ‘cancel and terminate the membership of such grower, together with all benefits accruing thereunder, and all voting power, right, and interest of every kind and nature shall immediately cease and terminate,’ it was entitled to retain the money in question and that the plaintiff was entitled to no part thereof. The court, however, held that the bylaws did not ‘apply to a surplus accruing from the sale and purchase of fruit and charges therefor, under an express contract, but are confined and limited to the right, title, and interest which a corporation or individual may have in and to the net assets of the association by reason of membership therein subject to the payment of all of its debts and liabilities. They do not give to the association the right to keep the money which it promised and agreed to pay another under its express contract.’ In other words, the member was entitled to nothing by reason of his membership, but was en-

titled to payment in accordance with his marketing contract.”

At page 125, the *Borgadus* case is cited among others in connection with the following statement:

“In the event an association using a purchase-and-sale contract were to fail, having on hand products or the money derived from the sale of them, a question would arise whether the members under such contracts were merely common creditors along with other unsecured creditors or whether they were preferred creditors. Apparently they would be common creditors, as this is the general rule in analogous situations in which title to goods that have not been paid for has passed. Again, when title to the products passes to an association, as is the case under the purchase-and-sale form, a creditor of the association after obtaining a judgment could seize a sufficient quantity of the products to satisfy his judgment.

“It has been said that even under a purchase-and-sale contract an association is essentially operating on an agency basis. There would appear to be more basis for this view in regard to the fiduciary duties of an association to its members than in any other respect.”

At page 155 the *Bogardus* case is cited for the following statement:

“In considering the matter of deductions a sharp distinction should be drawn between amounts in the hands of an association, arising from the sale of commodities delivered by its members and for which it may be said that the association is indebted to the members, and amounts which the association is authorized to retain out of such sale proceeds.”

At page 164 the *Bogardus* case is cited in connection with the following statement appearing on pages 163 and 164:

“The amount of all unauthorized deductions or withholdings may not properly be regarded as assets of an association; and even when an association is operating under a purchase and sale contract, money in excess

of authorized deductions, arising from the sale of commodities received by an association from its members for purposes of sale, does not constitute a part of the property of the association from the standpoint of a by-law providing that on the termination of membership the interest of a member in the property of the association shall cease. In other words, sums like those just referred to have the status of debts of the association; and, moreover, their retention is inconsistent with the nonprofit character of an association and the fiduciary relationship existing between an association and its members."

For the ready reference of the Court copies of Hulbert's book, "Legal Phases of Cooperative Associations" have been filed with the Clerk with the request that he lodge a copy with each of the judges hearing this case.

Modern cooperative marketing associations are an outgrowth of the economic needs of producers. Under the laws of forty-seven States they may be formed as corporations.¹ As corporations they are legal entities separate and apart from their members² but for the most part they are required to be so-called non-profit associations, i. e. they do not operate for their own profit nor for the profit of their stockholders or members as such, but for the profit of their members as producers.³ Herein they differ from the ordinary business corporation which operates for its own profit in the legal sense and for the profit of its stockholders in the economic sense. They are, nevertheless, capitalistic in nature,⁴ and are organized for pecuniary gain. In the ordinary corporation the economic or pecuniary gain is that of the stockholders in proportion to the capital contributed by them and in the cooperative association it is that of the members thereof in proportion to their production.⁵

¹ Nourse, "The Legal Status of Agriculture Cooperation," Macmillan 1928.

² L. S. Hulbert, "Legal Phases of Cooperative Associations," p. 28.

³ Sec. 1192 of the California Agricultural Code.

⁴ L. S. Hulbert *supra*, p. 1.

⁵ *Schuster v. Ohio Farmers' Cooperative Milk Association*, 61 F. (2d) 337 (C. C. A. 6). Therein the Court said: "Obviously, the co-operative marketing association is organized for profit in the sense of financial benefit to its

This difference in economic pattern which is brought about by provision in the bylaws of the cooperative association or in its marketing agreements or in the enabling acts, or by all of these, may spell out a difference in the legal relationship between the cooperative association and its members as compared with the legal relationship between the ordinary corporation and its stockholders. The economic or pecuniary relationship, however, remains the same whether or not the cooperative form constitutes a legal agency or a trust relationship between the cooperative association and its members as producers.

This discussion brings us to a consideration of the remaining questions propounded in the Court's Order.

Question 2. *Is it the law of California that the transfer of title of raw sugar to a cooperative by its members is from the members as principals, continuing to own the sugar, to their cooperative as agent, which holds title as agent to dispose of the sugar and return the proceeds to the members as principals?*

Answer. No. The California Agricultural Code provides as follows:

"1208. The association and its members may make and execute marketing contracts, requiring the members to sell, for any period of time, not over 15 years, all or any specified part of their products or specified commodities exclusively to or through the association, or any facilities to be created by the association. *If they contract a sale to the association, it shall be conclusively held that title to the products passes absolutely and unreservedly, except for recorded liens, to the association upon delivery; or at any other specified time if*

members. The element of departure from ordinary corporate economic practice is found in the fact that the financial gain is enjoyed by the members in proportion to the production, by each, of the products handled, rather than in proportion to the capital otherwise contributed by each to the conduct of the business; but this difference of economic principle governing the distribution of wealth cannot alter the fact that the sole incentive to membership in such an association is the financial benefit to be derived therefrom in the marketing of the farm products which the member is producing. There is nothing broadly eleemosynary in cooperative associations. They simply represent a banding together of producers for their common good, and the motive of each is pecuniary gain."

expressly and definitely agreed in the said contract. The contract may provide that the association may sell or resell the products delivered by its members, with or without taking title thereto; and pay over to its members, the resale price, after deducting all necessary selling, overhead and other costs and expenses, including interest on preferred stock, not exceeding 8 per cent per annum, and reserves for retiring the stock, if any; and other proper reserves; and interest not exceeding 8 per cent per annum upon common stock.” (Emphasis supplied)

The marketing agreement (R-28) is an “agreement of purchase and sale” and provides (R-41):

“(B) Title to sugar delivered at the Port of San Francisco shall pass to the Buyer as soon as weighed at time of discharge from the ship; title to sugar for delivery at other ports shall pass to the Buyer upon arrival of vessel at port of destination;”.

The only provision of the marketing agreement under which an agency relation might exist is that contained in paragraph (E) under the heading of “Unavoidable Casualty” (R-42) which would make performance of the contract impossible.

The marketing agreement further provides (R-46):

“(O) The provisions of this agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns.”

The death of the principal or agent terminates the relationship of agency (see Secs. 120 and 121, Restatement of the Law of Agency).

There is no provision in the marketing agreement for control by the producer of the manner or method of disposing of the members’ product except that his product may not be sold to another refinery company unless he so instructs (R-29).

The California Agricultural Code also provides for injunctive relief and specific performance:

“1210. In the event of any such breach or threatened breach of such marketing contract by a member, the association shall be entitled to an injunction to prevent the further breach of the contract and to a decree of specific performance thereof. Pending the adjudication of such an action and upon filing a verified complaint showing the breach or threatened breach, and upon filing a sufficient bond, the association shall be entitled to a temporary restraining order and preliminary injunction against the member.”

If a contract to sell is specifically enforceable it is a contract of sale and not a contract of agency (*Ansley Realty Co. v. Pope*, 105 Texas 440, 151 S. W. 525).

The California Agricultural Code also provides for limited liability:

“1206. * * * No member or stockholder shall be liable for the debts of the association to an amount exceeding the sum remaining unpaid on his membership fee or his subscription to the capital stock, including any unpaid balance on any promissory note given in payment thereof.”

A principal is fully liable for the acts of his agent within the scope of his authority (Section 140, Restatement of the Law of Agency).

Chapter 1, Section 1 of the Restatement of the Law of Agency contains the following definition of “agency”:

“Agency is the relationship which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act.”

and in Section 14 of said Restatement:

“A principal has the right to control the conduct of the agent with respect to matters entrusted to him.”

Comment c to this Section is as follows:

“c. There are many relationships in which one acts for the benefit of another which are to be distinguished

from agency by the fact that there is no control by the beneficiary. Thus, executors, guardians, and receivers, although required to act wholly for the benefit of those on whose account the relationship has been established, are not subject to their directions. A trustee, that is, one holding property in trust for another and subject to equitable duties to deal with the property for the other's benefit, may or may not be subject to control in the management of the property by the one for whose benefit he is required to act. If he is so subject, he is also an agent, and the rules stated in the Restatement of this Subject apply to him. The directors of a corporation for profit are fiduciaries having power to affect its relations, but they are not agents of the shareholders since they have no duty to respond to the will of the shareholders as to the details of management. The partnership relationship, while having many of the characteristics of the agency relationship, differs from it in that a partner's power to bind his co-partner is not subject to the co-partner's right of control unless there is an agreement to that effect."

The relation of agency is revocable at the will of either the principal or agent (Sec. 18 and 19, Restatement of the Law of Agency).

The marketing agreement in this case does not permit termination by either party within a contract year (see paragraph (K) (R-44, 45).

In the agency relation the agent represents and acts for the principal and his acts are binding on the principal (2 C. J. S. 1035. Note 33 and 34 citing *Taylor v. Davis*, 4 Sup. Court 147, 150, 110 U. S. 330).

Under the marketing agreement in the case at bar petitioner in the comparable position of agent does not act for each producer who would occupy the comparable position of principal, but with respect to the product of each producer acts for all the producers.

Sec. 8 of the Restatement of the Law of Trusts distinguishing trusts and agency contains the following comment:

"a. *Title.* A trustee has title to the trust property; an agent as such does not have title to the property of

his principal, although he may have powers with respect to it.

“b. *Control*. An agent undertakes to act on behalf of his principal and subject to his control (see Restatement of Agency, § 1); a trustee as such is not subject to the control of his beneficiary, except that he is under a duty to deal with the trust property for his benefit in accordance with the terms of the trust and can be compelled by the beneficiary to perform this duty.

“c. *Liability*. An agent may subject his principal to personal liabilities to third persons; a trustee cannot subject the beneficiary to such liabilities (see § 274).

“d. *Consent*. An agency is created by the consent of the principal and the agent (see Restatement of Agency, § 1); a trust may be created without the knowledge or consent of the beneficiary or of the trustee (see §§ 35, 36).

“e. *Termination*. An agency can be terminated at the will of either the principal or the agent and is terminated by the death of either (see Restatement of Agency, §§ 118-121). A trust is not ordinarily terminable at the will of either the beneficiary or the trustee or by the death of either (see §§ 330, 337).

“f. *Agent may also be trustee*. A person may be at the same time both an agent and a trustee for the same person. If an agent is entrusted with the title to property for his principal, he is a trustee of that property.”

From the foregoing we conclude that it is not the law of California that the transfer of title of raw sugar to a cooperative by its members is from the members as principals, continuing to own the sugar, to their cooperative as agent, which holds title as agent to dispose of the sugar and return the proceeds to the members as principals.

But if the contrary view should prevail then there is authority for holding that a refund of the processing tax may be made in a suit by the principal and agent jointly. See *Cheek et al v. U. S.* (40-2 U. S. T. C. par. 9687, affirmed C. C. A. 6, 126 F. (2d)1) where just that was done.

In filing the claim for refund in 11488 petitioner took the precautionary step of having all its members join in that

claim "to the extent that they may be necessary, legal or equitable parties" by the execution under oath of Schedule 3 by all of such members (R-73-78). If it should be the view of the court that petitioner paid the processing tax acting as agent for its members as principals and that said members as principals were necessary parties to this action in the Tax Court then it would be appropriate for petitioner to have leave to amend the petition in the Tax Court by joining its members as parties to the petition.

Question 3. *Is it the law of California that such a transfer transfers the sugar to the cooperative as trustee of a trust of which the selling members are beneficiaries and the provisions of the trust are the terms of the contract of sale?*

Answer: Yes. All the necessary elements of a complete trust are present in the transaction in which petitioner's members deliver raw sugar to petitioner as a cooperative association organized under the laws of California under the marketing agreement which imposes a duty upon petitioner to account to its members.

An express trust may be created even though the parties do not call it a trust, and even though they do not understand precisely what a trust is; it is sufficient that what they appear to have in mind is in its essentials what the courts mean when they speak of a trust (sec. 2.8, 1 Scott on Trusts 37).

Chapter 1, section 2 of the Restatement of the Law of Trusts defines a trust as follows:

"A trust, as the term is used in the Restatement of this Subject, when not qualified by the word 'charitable,' 'resulting' or 'constructive,' is a fiduciary relationship with respect to property, subjecting the person by whom the property is held to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of an intention to create it."

Comment "h. The elements of a trust. As appears in this Section a trust involves three elements, namely, (1) a trustee, who holds the trust property and is subject to equitable duties to deal with it for the benefit

of another; (2) a beneficiary, to whom the trustee owes equitable duties to deal with the trust property for his benefit; (3) trust property, which is held by the trustee for the beneficiary."

Scott in analyzing the above definition of a trust has this to say (Section 2.3, 1 Scott on Trusts 32-33):

"In this definition or description the following characteristics are to be noticed: (1) a trust is a relationship; (2) it is a relationship of a fiduciary character; (3) it is a relationship with respect to property, not one involving merely personal duties; (4) it involves the existence of equitable duties imposed upon the holder of the title to the property to deal with it for the benefit of another; and (5) it arises as a result of a manifestation of intention to create the relationship. The combination of these things characterizes the notion of the trust, as that notion has been developed in the Anglo-American law."

Applying these tenets to the situation in the case at bar we find:

1. The relationship between petitioner as a cooperative association and its members as producers is a fiduciary relationship.⁶

2. This relationship is with respect to property—the raw sugar produced by the members as it is delivered under the marketing agreement and title thereto passed to petitioner.

3. Petitioner has the equitable duty to account to and for the benefit of its members.

4. The manifestation of intention to create the relationship is implicit in the organization of petitioner as a non-profit cooperative marketing association under the laws of California for the profit or benefit of its members and the entering into the marketing agreement involving the duty to account.

⁶ L. S. Hulbert "Legal Phases of Cooperative Associations," p. 5, citing among other cases *Bogardus v. Santa Ana Walnut Growers Association*, 41 C. A. 2d 939; 108 Pac. 2d 52.

There are present in the situation in the case at bar all of the components of a trust relationship—settlor, trust property, trustee, and beneficiary (Section 3, Restatement of the Law of Trust).

Each member (they contracted severally, R-54) became a settlor of the trust fund for each contract year by delivering raw sugar to the petitioner in accordance with the terms of the marketing agreement.

The raw sugar so delivered with passage of title to petitioner was the trust property.

Petitioner by taking title to the raw sugar under the marketing agreement with the duty to account to its members for the proceeds thereof was in the position of a trustee.

Petitioner's members in the aggregate for whose benefit the raw sugar was sold are the beneficiaries of the trust.

We have seen above that a trust differs from an agency. The trust also differs from a debt. This difference lies principally in the fiduciary relationship based on the duty to account which exists in a trust but does not exist in a debt. This difference has its origin first in the distinction between the common law action of account and action of debt and later in the distinction between actions at law and in equity. (See Sec. 12, 1 Scott on Trusts 82).

From the foregoing we believe it may be properly held that it is the law of California that such a transfer transfers the sugar to the cooperative as trustee of a trust of which the selling members are beneficiaries and the provisions of the trust are the terms of the contract of sale.

In the petitioner's initial brief before this Court this question was touched upon (P-27) as follows:

“The only legal difference between the position of petitioner's members as producers and the common stockholders of the ordinary corporation with respect to profits from operations is one of time of accounting, and in examining ultimate effects the time element is not material. An Agricultural Cooperative accounts to its members on a crop basis or annually, and sometimes oftener depending on the kind of product han-

dled. Petitioner accounted to its member-producers on the annual basis of a fiscal year ending November 30. An ordinary business corporation may account annually or oftener by way of distributing dividends from profits, but must in all events account fully to its common stockholders on liquidation. In both accountings, regardless of the time when they occur, any burden borne by either the cooperative or the ordinary corporation will be reflected in the amounts received by the persons entitled thereto. The immediate economic effects in both are the same.

“The similarity of petitioner and its members as producers with a partnership and its members, or with a trustee and his beneficiaries with respect to accounting for profits is perhaps even more pointed. The profits of a partnership are either distributed or credited to the members annually because they belong to the members. Likewise in the case of a trustee, he will either distribute any profits of his business to his beneficiary or accumulate them for his benefit very much the same as petitioner accounts annually to its members as producers. In all these situations if the business entity has borne some burden chargeable to operations, such as a processing tax, there will be less to account for or pay to the member as producer of the product, to the common stockholder, to the partner, and to the trust beneficiary.

“The real question in these situations is: whether this lessening of the profits which would have otherwise accrued to the benefit of the member, stockholder, partner or beneficiary if the tax had not been paid, constitutes a shifting of the burden of the tax to them by their respective business organizations.”

Question 4. *If the transfer of title of the sugar is in such a trust does the cooperative as trustee, by paying the processing taxes out of the corpus of the trust, shift the burden of the taxes by the reduced amount distributed to the beneficiary members?*

Answer. No. Petitioner was liable for and paid the tax as the processor. As such processor its capacity was that of a trustee for the benefit of its members as beneficiaries. The members' beneficial interest was in the net proceeds of

petitioner's operations as such trustee—not in the gross proceeds. The net proceeds to which the members' beneficial interest attached was determinable only after deducting all authorized expenses which the petitioner as trustee incurred. The taxes imposed were an authorized expense.

The extent of the interest of the beneficiary of a trust depends upon the manifestation of intention of the settlor (Sec. 128, Restatement of the Law of Trusts).

In this case there is a specific provision of the marketing agreement manifesting this intention as follows:

“The remainder, after the deductions above enumerated, shall constitute the total payment” (R-62).

“Total payment” as here used represents the entire beneficial interest of the members in the trust formed by their delivery of raw sugar to the petitioner under the marketing agreement.

While an agent represents and acts for his principal, as we have seen above, a trustee has no principal (Taylor v. Davis, *supra*) and cannot render the creator or beneficiary of the trust liable for his contracts (Sec. 275, Restatement of the Law of Trusts).

A trustee, on the other hand, is liable for his contracts both as trustee and, personally if his trust assets are insufficient to indemnify him. (Sec. 261-263, Restatement of Law of Trusts).

As in the case of all representative or artificial entities where a burden or liability is borne by such entity in its representative capacity the effects thereof are felt by those persons having the beneficial, economic or pecuniary interest in the assets of such entity. But this economic tenet does not mean that there is in such a situation a shifting of the burden or liability from the representative entity upon which it was placed to the persons beneficially or pecuniarily interested therein.

Congress in enacting Title VII of the Revenue Act of 1936 did not intend to bar recovery in any such situation.

To have so provided specifically would have confined all refunds of the invalidated processing taxes to natural persons acting in their individual capacity and this would constitute a denial of the equal protection of the law and the denial of due process contrary to the Constitution. The government made no contention for such an interpretation in the case of *Anniston Manufacturing Company v. Davis*, 301 U. S. 337, 57 Sup. Ct. 860, in which the constitutionality of Title VII as there interpreted was tentatively upheld.

Except in the instant case thus far the law has not been so construed either administratively or judicially.

We have no way of knowing or citing the many administrative cases of refund that have been made. The reported cases in which refunds to ordinary business corporations have been judicially determined are numerous and the question of the shifting of the burden to the stockholders having the economic or pecuniary interest in the assets of the corporation has never been raised.

Counsel for petitioner has examined the dockets and files of the now defunct Processing Tax Board of Review and its successor in jurisdiction, the Tax Court of the United States, and has found the following cases where refunds have been determined, of trustees, receivers and executors or administrators and one partnership as the titles of the cases will indicate. The decisions of these cases are nowhere reported and counsel therefore hesitates to cite them. They are cited with as much accuracy and detail as possible for the proposition that refunds have been made to persons occupying a representative fiduciary capacity such as that of petitioner. Certified copies of the orders deciding these cases have been requested from the Clerk of the Tax Court and if obtained will be sent on to the Clerk of this Court. As a note to each of the cases cited counsel indicates by whom the tax in question was paid which is revealed only by a comparison of the dates of the payment of the tax with the date of the appointment of the fiduciary representative filing the petition therein.

George J. Lockner, Trustee in Bankruptcy of Bloecher & Schaaf, Inc. v. Commissioner PTBR Doc. No. 76. Order entered April 21, 1939. Refund due, \$10,000. Note: Tax paid by corporation before receiver's appointment.

Doris Sindlinger, Administratrix of the Estate of C. P. Sindlinger v. Commissioner PTBR Doc. No. 88. Order entered Nov. 12, 1940. Refund due, \$4496.12. Note: Tax paid by administratrix.

L. J. Blakey, receiver for Mebane Flour Mills, Inc. v. Commissioner. PTBR Doc. No. 228. Order entered May 5, 1940. Refund due, \$4,509.12. Note: Tax paid by corporation before appointment of the receiver.

G. C. Byars, Trustee in Bankruptcy for Summerville Cotton Mills v. Commissioner. PTBR Doc. No. 234. Order entered December 7, 1942. Refund due, \$17874.28. Note: Tax paid by corporation before receiver appointed.

King-Perkins Bag Co., a copartnership v. Commissioner PTBR 347. Order entered April 29, 1942. Refund due, \$2,572.92. Note: Tax paid by partnership.

George W. Mount Castle, receiver for Pamona Mills, Inc., v. Commissioner, PTBR Doc. No. 368. Order entered Feb. 17, 1942. Refund due, \$8,500. Note: Tax paid by receiver after appointment.

Powers-Beggs & Co. Lewis Kelly v. Commissioner. PTBR Doc. No. 391. Order entered Nov. 10, 1942. Refund due, \$6,203.76. Note: Tax paid by receiver after appointment.

James F. Kelley and Roy D. Marshall, receivers for Croeninger Packing Co., Inc. v. Commissioner. PTBR Doc. No. 407. Order entered Dec. 16, 1943. Refund due, \$8,144.15. Note: Tax paid by corporation before receivership.

In none of these cases was the point raised that the fiduciary claimant had shifted the burden of the tax to his beneficiary although in those cases where the fiduciary paid the tax the point would have been available if it is available in the case at bar.

From the foregoing we conclude that the transfer of title of the sugar being in such a trust the cooperative as trustee, does not by paying the processing taxes out of the corpus of the trust, shift the burden of the taxes by the reduced amount distributed to the beneficiary members.

Question 5. *Under the facts alleged in the petitions to the Tax Court, if the sugar be resold by the cooperative at a net loss, does the loss fall on the beneficiary members or on the capital of the cooperative trustee?*

Answer. The net loss as we understand the term, would fall upon the capital of the cooperative trustee. As we understand the term "net loss" as used in this question it means the loss that would result if petitioner resold the sugar delivered by its members for a total price which when added to its other income, was insufficient to cover its operating expenses and other authorized deductions, without attributing to or deducting any amount as the cost of the raw sugar delivered by its members. Such a situation is barely conceivable but if it should occur the loss would definitely fall on petitioner's own capital rather than on its members as producers. This result is based on three grounds:

1. The California Agricultural Code contains the following provision:

"1206. * * * No member or stockholder shall be liable for the debts of the association to an amount exceeding the sum remaining unpaid on his membership fee or his subscription to the capital stock, including any unpaid balance on any promissory note given in payment thereof."

2. The marketing agreement makes no provision for charging the member-producers with such loss.

3. A trustee cannot subject his beneficiary to liability to third persons from which such "net loss" would result (see Restatement Law of Trust, Sec. 274).

On the other hand, if what is meant by the term "net loss" is where petitioner should fail to resell the sugar de-

livered by its members at a price which when added to other income, was insufficient to cover its operating expenses and other authorized deductions, *and the advances which petitioner made to its members toward and on account of the "total payment" provided in the marketing agreement*, then a different result would follow. Such a situation would constitute an over-advance and the net loss resulting therefrom would be recoverable from those members to whom the over-advance had been made. This conclusion is based on the fact that under the cooperative method of operation and under the marketing agreement in this case as alleged in paragraphs V (15), (16) and (17) (R 11-12) each member must receive the exact same amount per unit as each other member adjusted only for polarization premium or penalty—quality.

With respect to over-advances by a cooperative association Hulbert, "Legal Phases of Cooperative Associations," pages 145 and 147, has this to say:

"Cooperative associations frequently make advances or partial 'payments' to their members on receipt of their products. The question arises, in the event the advances or payments made exceed the amount to which the member is entitled, after deducting marketing expenses and all other authorized deductions from the sales returns, may the association recover the amount of such excess advances or payments from the member? The answer is 'Yes.' The basis for the recovery is the doctrine that no man shall be allowed to enrich himself unjustly at the expense of another or shall be allowed to retain money that in 'equity and good conscience' belongs to another."

* * * * *

"When excess advances or payments are made by an association that functions on a pool basis, there is always the strong possibility that some members have received less than they were entitled to; whereas other members have received more than the amount to which they were entitled. This situation would provide an additional reason for allowing an association to recover excess advances. The principles under discussion are

applicable, even in cases in which an association in its contract agrees to make an advance of a specified amount to growers, which amount proves to be excessive, because both parties assume that the products will bring a net amount larger than the advance. If this assumption proves to be incorrect, the necessary adjustments are in order. The association contracts to pay to its members only the net amount received by it for their products, minus authorized deductions. If more is paid, a member has received something to which he has no claim. No reason is apparent why these principles would not be as applicable to an unincorporated as to an incorporated association; and, in a Kentucky case involving an unincorporated association, the members were held liable for over-advances made to them."

Since petitioner's cost of raw sugar delivered by its members depends entirely upon there being net proceeds from petitioner's entire operations, if there are no net proceeds the raw sugar acquired from them would have no cost.

We conclude that "a net loss" determined on this basis would fall on the capital of petitioner for the reasons above stated.

Respectfully submitted,

HENRY J. RICHARDSON,
Transportation Building,
Washington 6, D. C.,

WALTER C. FOX, JR.,
111 Sutter Street,
San Francisco 4, California,
Attorneys for Petitioner.